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# In the Supreme Court of the United States

OCTOBER TERM, 1926

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SAMUEL J. KORNHAUSER, PETITIONER

*v.*

THE UNITED STATES

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

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## BRIEF FOR THE UNITED STATES IN OPPOSITION

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### OPINION BELOW

The opinion of the Court of Claims (R. 7–8) has not yet been officially reported.

### JURISDICTION

The judgment to be reviewed was entered November 16, 1926. (R. 9.) Petition for certiorari was filed January 12, 1927. (R. 9.) Jurisdiction to issue the writ is conferred by Section 3 (b) of the Act of February 13, 1925. (Ch. 229, 43 Stat. 936, 939.)

### THE QUESTION

The question presented is whether the amount of attorney's fees paid by petitioner for defense of an action for accounting brought against him by a

former law partner was a business expense deductible from gross income in computing net taxable income under the Revenue Act of 1918.

## STATEMENT

In this case the petitioner filed a suit in the Court of Claims for the refund of income tax. The Government demurred to the petition and the demurrer was sustained by the court. A review is now sought of such ruling. The petition alleged that the petitioner paid the sum of $10,000 to an attorney, as fees, for defending him in a suit for an accounting filed against him by his former copartner, it being claimed in said suit that petitioner had collected legal fees in which his said copartner was entitled to share. (R. 5.) The petitioner, in filing his tax return, claimed a deduction of the said $10,000 as an ordinary and necessary business expense or as a business loss.

The Commissioner of Internal Revenue denied the petitioner's claim and assessed and collected an additional tax of $1,126.15. A claim for refund of the tax was duly filed by petitioner and rejected by the Commissioner of Internal Revenue. (R. 6.)

The Court of Claims in sustaining the demurrer held that said payment of legal fees was not a necessary and ordinary expense in trade or business, but was a personal expense which was not deductible under the statutes.

## STATUTES INVOLVED

The sections of the Revenue Act of 1918 (Ch. 18, 40 Stat. 1057), involved herein are as follows:

> SEC. 214 (a). That in computing net income there shall be allowed as deductions:
>
> (1) All the *ordinary and necessary expenses* paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity;
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, *if incurred in any transaction entered into for profit*, though not connected with the trade or business; * * *.
>
> SEC. 215. That in computing net income no deduction shall in any case be allowed in respect of—
>
> (a) *Personal*, living, or family expenses * * *. (Italics supplied.)

## ARGUMENT

There is no important Federal question and there is no question of great importance to taxpayers in general involved in this case, even though the question may be important to the petitioner. A claim for a deduction of this kind is an exception rather than a rule. The language of the Revenue Acts setting out what are allowable deductions and what are not allowable deductions is plain and unambiguous and does not require construction by this Court.

It is argued by petitioner that the expense of defending the action was incurred primarily and exclusively because of his business with his former partner and that the expense was a necessary one within the meaning of Section 214(a)(1) of the Revenue Act of 1918. This argument is answered by the fact that the attorney's fee paid out in the defense of the suit did, in nowise, affect petitioner's business. The partnership had already been dissolved and, regardless of how the suit was decided, it would not enhance or decrease the income of the partnership. This expense was a personal one and was brought about by a personal action of the petitioner which was entirely separate and apart from any business transaction.

Petitioner next argues that the expense was a loss incurred in trade or business not compensated

for by insurance or otherwise. The expense was not incurred in trade or business within the meaning of the words " in trade or business " as used in the Revenue Act, but was incurred in an isolated transaction. For the definition of the words " in trade or business " as used in the Revenue Acts, see the case of *Mente* v. *Eisner*, 266 Fed. 161.

Petitioner further argues that he is entitled to a deduction of the attorney's fee expended by him in defending the suit under Section 214(a) (5) of the Revenue Act of 1918, for the reason that it was a loss incurred in a transaction entered into for profit. There is no merit to this argument for the reason that the transaction which brought about the loss, if there was a loss, was the law suit and it certainly cannot be argued that the plaintiff entered into a law suit brought against him for an accounting with the expectation of making a profit therefrom.

It appears that the expenditure sought to be deducted by the petitioner in this case can be nothing except a personal expenditure which was incurred by the petitioner by reason of the belief of his former law partner that the petitioner had committed some personal wrong against him; and that the decision of the Court of Claims in this case was correct.

In any event this case is not one justifying consideration by this Court, and the petition for writ of certiorari should be denied.

Respectfully submitted.

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MARCH, 1927.

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# In the Supreme Court of the United States

OCTOBER TERM, 1927

No. 162

SAMUEL J. KORNHAUSER, PETITIONER

*v.*

THE UNITED STATES

*ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

## BRIEF FOR THE UNITED STATES

### OPINION OF THE COURT BELOW

The opinion of the Court of Claims (R. 7–8) is reported in 62 Ct. Cls. 647.

### GROUNDS OF JURISDICTION

The judgment to be reviewed was entered November 16, 1926. (R. 9.) Petition for certiorari was filed January 12, 1927. (R. 9.) Jurisdiction to issue the writ is conferred by Section 3 (b) of the Act of February 13, 1925. Petition for writ of certiorari was granted April 11, 1927 (47 Sup. Ct. 570).

### THE QUESTION

The question presented is whether or not moneys paid as attorney's fees in defending an action for an accounting brought against the petitioner by a former law partner were deductible from gross income in computing net income taxable for the year 1918.

### STATUTES INVOLVED

The sections of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1066, 1069, involved herein are as follows:

> SEC. 214 (a). That in computing net income there shall be allowed as deductions:
>
> (1) All the *ordinary and necessary expenses* paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity;
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, *if incurred in any transaction*

*entered into for profit*, though not connected with the trade or business; * * *.

SEC. 215. That in computing net income no deduction shall in any case be allowed in respect of—

(a) *Personal*, living, or family expenses; * * *. (Italics supplied.)

## STATEMENT OF THE CASE

This suit was instituted in the Court of Claims to recover the sum of $1,126.15, together with interest, which amount petitioner alleged had been erroneously assessed against and collected from him as income taxes for the year 1918. (R. 5–6.) A demurrer interposed by the Government to the petitioner's statement of claim was sustained. (R. 4.) An amended petition was filed, to which the Government also demurred. This demurrer was also sustained and the petition dismissed (R. 7), and a review is now sought of the Court's ruling in sustaining the Government's demurrer to the amended petition filed herein.

Petitioner, an attorney at law, alleges (R. 5) that in 1918 he paid the sum of $10,000.00 to an attorney as fees for defending an action brought against him in a state court of Ohio by a former law partner for an accounting, in which action it was alleged that certain shares of stock received by this petitioner in 1918 represented compensation for legal services performed during the existence of the partnership. Petitioner contends that the attorney's fee so paid was deductible from his gross income

in 1918 under subsection (a), (1), (4), or (5) of Section 214 of the Revenue Act of 1918, *supra*. The suit for accounting was successfully defended and judgment was rendered in petitioner's favor.

The court below in sustaining the Government's demurrer held that the attorney's fee expended in defending said action was a personal expense and that Section 215 (a) of the Revenue Act of 1918 expressly prohibited the claimed deduction. (R. 8.)

## SUMMARY OF THE ARGUMENT

It will be argued that the expenditure incurred by petitioner in defending an action for accounting brought against him by his former law partner was not such an expense as is deductible under the provisions of Section 214 of the Revenue Act of 1918, but that said attorney's fee was a personal or capital expenditure and that Section 215 of the Revenue Act of 1918 expressly prohibits petitioner from deducting such expense from his gross income for the year 1918.

## ARGUMENT

### THE ATTORNEY'S FEE PAID BY PETITIONER IN DEFENDING AN ACTION FOR AN ACCOUNTING BROUGHT AGAINST HIM BY A FORMER LAW PARTNER IS NOT DEDUCTIBLE

Congress, at the time of the passage of the Revenue Act of 1918, as well as other Acts, realized that all taxpayers would incur certain expenses in making an income and determined to allow taxpayers to reduce their taxes by allowing them to deduct certain expenses. The expenses to be deducted were

to be of a common nature to all taxpayers in proportion to the amount of income received by them. This is shown by the use of the words " ordinary and necessary" used in Section 214(a). On the other hand, Congress realized that there were certain expenses, such as personal, living, and family, which would not be in the same proportion as the income made, for some taxpayers lived on a larger percentage of their income.

All expenses to be deductible must come clearly within the provisions of Section 214.

Petitioner insists that the expense he is seeking to deduct comes within the provisions of Section 214 (a) of the Revenue Act of 1918, and that it was either an ordinary and necessary expense paid or incurred during the taxable year in carrying on a trade or business, or that it was a loss not compensated for by insurance or otherwise incurred in trade or business, or that it was a loss sustained in the taxable year and not compensated for by insurance or otherwise incurred in a transaction entered into for profit, though not connected with the trade or business.

Although there is some suggestion in the petitioner's brief that the transaction involved in this case constituted a "loss," which may be deducted from gross income under subsection (4) or (5) of Section 214 (a), it seems so clear that a payment for services rendered is not a "loss" within any definition of that word that to state the proposition

is to deny it. The conception of "loss" is negative receipt of value, for a loss presupposes something to be lost; it signifies destruction. Certainly the taxpayer did not lose the money he paid for legal services, for he received in return the services of his attorney, which it may be supposed aided the petitioner in securing a judgment in his favor in the State courts. It seems clear that there can be no "loss" here, for not only did the petitioner secure a judgment of the court for the money for which he was asked to account but his reputation, which was also involved in the case, was vindicated. The attorney's fee expended by the petitioner was nothing more than an *unusual* expense to which the petitioner was put in defending his personal property or reputation, or both. Again, it seems obvious from the reading of subsections (a), (4), and (5) of the Revenue Act of 1918 that Congress had in mind no such transaction as the one in this case, for the reason that it spoke of losses compensated for by insurance and losses incurred in any transaction entered into for profit where said transaction was not connected with the trade or business. It appears evident that if such an expense as the petitioner is claiming as a deduction could be brought within the meaning of a "loss" it was not such a "loss" as was capable of being insured, and it is just as evident that the taxpayer did not willfully engage in defending a lawsuit brought against him for an accounting of funds for the purpose of mak

ing a profit, but that he entered into the defense of such an action involuntarily for the purpose of preserving and making more secure his moneys or property already owned as well as for vindicating his reputation, which was at stake by the suit for an accounting.

The serious question in this case arises when it is sought to place this transaction on one side or other of the line drawn by the statute between "ordinary and necessary expenses paid or incurred in carrying on any trade or business" on the one hand, and "personal, living, or family expenses" on the other. This line is shadowy, for many transactions partake of the nature of both classes of expenses. Thus the transportation of one to his place of business may be said to be a business expense if approached from the viewpoint of necessity of conducting business at a given location. On the other hand, it may be said to be a personal expense when considered as arising from the personal choice of a dwelling place.

But manifestly the statute does not contemplate that one's point of view should determine the deductibility of expenses. Some more accurate and unvarying standard is undoubtedly intended. That standard, it is submitted, is the implications of words in the common understanding. The common understanding of the phrase "business expense" is very aptly described in the regulations promulgated by the Commissioner. The pertinent

part of Article 101 of Regulations 45 (1921 ed.) is as follows:

> *Business expenses.*—Business expenses, whether subtracted from total receipts in computing gross income or deducted from gross income in computing net income, include all items entering into what is ordinarily known as the cost of goods sold, together with selling and management expenses, except such classes of items as are treated in articles 121 to 268. Among the items to be treated as business expenses are material, labor, supplies, and repairs in the case of a manufacturer, while a merchant would include his purchases of goods bought for resale. In either case the amount to be taken as a deduction in any year should be determined by taking into consideration the inventory at the beginning and end of the year. Other items that may be included as business expenses are reasonable compensation for the services of officers and employees, advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident or other similar losses in the case of a business, and rental for the use of business property. But see article 294. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source.

Article 101 of Regulations 62 is practically the same as the above-quoted article.

The pertinent part of Article 101 of Regulations 65 is as follows:

> *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 121–251. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 35.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 102), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. But see article 293. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source.

Article 101 of Regulations 69 is practically the same as the above-quoted article.

As elaborating on and explaining these regulations, the following is quoted from an office ruling published in 1919:

"Business expenses," as defined in article 101, Regulations 45, includes all items entering into what is ordinarily known as the cost of goods sold, together with selling and management expenses. In short, every necessary item of expense in conducting business, incurred primarily because of and solely in the furtherance of the business engaged in, is held to be an ordinary and necessary business expense.

To what extent can this definition of business expenses be applied? Does it include any and all expenses which in any way bear upon or have a relation to or a connection with the business engaged in by the individual? Obviously, amounts paid out for medical attention necessary for the upkeep of the body and the preservation of health are personal and have no connection with business. Likewise, sums paid to the grocer, to the tailor, amounts paid for insurance and house rent. These expenses arise independently of business. The test, therefore, is whether an expense is incurred primarily because of business as the immediate cause inducing the expenditure. (1 C. B. 101.)

The expenditure in this case does not meet with the test laid down in the above-quoted office ruling. It arose independently of the taxpayer's business and was not incurred primarily because of business or as the immediate cause of inducing the expenditure. The expense of protecting one's property, although that property has been acquired by reason of business done in the past, relates to and

arises from *ownership*, not *business*. It is, except for food and shelter, perhaps the purest form of personal expense. The necessity of defending one's reputation is certainly no more a business expense than is the necessity of protecting one's health. Both health and reputation are necessary to the successful conduct of business, whether it be the business of a lawyer, that of a merchant, doctor, or minister of the gospel. It is difficult to conceive of an expenditure more personal than the one here under consideration. The action for an accounting was inspired and brought about because the former law partner of the taxpayer believed that a personal wrong had been committed against him by the petitioner and the defense of the action was undertaken, successfully in this case, for the protection of petitioner's property owned and accumulated, as was shown, outside of his trade, business, or profession, that of practicing law, and for the further defense of his reputation and good name, both of which are entirely personal to the taxpayer and not connected with his trade, business, or profession. The action for an accounting was begun after the partnership had been dissolved, all of its affairs wound up, and the partnership relation had ceased to exist, and regardless of the outcome of the action for an accounting the petitioner's business would have been in nowise affected. If the suit had been lost by the petitioner the result would have been that petitioner's personal fortunes would have been reduced by the amount of the judgment.

The statute requires that expenses to be deductible must be both "ordinary" and "necessary." Neither qualification alone comes within the purview of the statute and does not make an expense deductible. The deduction intended to be allowed is one of the usual or common and essentially a reasonably necessary expense in the case of persons doing a similar kind and volume of business, and, by implication, extraordinary and unnecessary expenditures in the maintenance and operation of a business, are excluded. Thus, in the case of *Chapin* v. *Irwin*, unreported except in 3 Am. Fed. Tax Rep. 3429, a jury found that certain expenses relating to the operation of a farm were not necessary and ordinary because they were very large. In the case of *Laemmle* v. *Eisner*, 275 Fed. 504, the court held that the attorney's fee paid in litigation for control of certain stock, resulting in practically the ownership or control of the company, and the consequent management of the company, was not an ordinary and necessary expense of carrying on business, but was an extraordinary expense properly chargeable to capital account. It would certainly be an unsound contention on the part of the petitioner that the defense of actions of accounting is an ordinary occupation of a lawyer or a usual incident to his business. It is fortunately only an extraordinary and unusual circumstance that necessitates such an expenditure. Yet the defense of this suit for an accounting must be attributable to a purpose to pro-

tect property or to vindicate reputation. The latter is by its expression clearly a personal expense, and the former is not only a personal expense but also a capital expense, the deduction of both of which is expressly forbidden by the statute (Section 215 (a) (b) and (c) of the Revenue Act of 1918).

*Appeal of Hewes*, 2 B. T. A. 1279.

*Appeal of Cons. Mutual Oil*, 2 B. T. A. 1067.

*Appeal of Palmer*, 3 B. T. A. 403.

The statute moreover provides that to be deductible the expense must be incurred in carrying on a business. Merely the facts of the instant case exclude the deduction claimed by petitioner. Defending the action against him was a single isolated transaction, and a loss incurred in such transaction is not deductible. See *Mente* v. *Eisner*, 266 Fed. 161. Here the most that can be said for the taxpayer is that he was put to an expense in winding up or closing out the business. The alleged misappropriation of moneys was not said to have been in the course of his business but in the course of his previously existing partnership business. Whether he won or lost the suit for an accounting filed against him would not affect his present business or its profit, as is demonstrated by assuming that at the dissolution of the old partnership a new one had been formed between the taxpayer and persons other than his former partner. Clearly the new partners would not have benefited or suffered from

the outcome of the suit for an accounting or been called upon to pay any part of the attorney's fee expended in defending said action.

If it be said that the application of the statute as here limited requires a literal interpretation of its words and a refusal to liberalize its provision, the Government will accept the consequences of the premises, although it does not concede that its construction is more than a fair reading of the statute, for this Court has repeatedly said that deductions can not be taken as a matter of right, but that they are in the nature of exceptions which must be strictly construed against allowance and allowed only by express provisions.

It is insisted that the expenditure which plaintiff was seeking to deduct from his gross income for the year 1918 was not an ordinary and necessary expense such as is deductible under Section 214 (a) (1), nor was it a "loss" such as is deductible under subsections (a) (4) or (5) of Section 214, but that said expense is a personal or capital expense which Section 215 (a) expressly provides shall not be deducted from gross income.

The above brief was prepared by the Bureau of Internal Revenue. We are not in accord with its reasoning nor with the conclusion reached by the

Court of Claims, but feel bound to submit the case to this Court for decision. A judgment based on a confession of error would not bind the Court of Claims in other like cases. The Bureau of Internal Revenue believes that the decision of the Court of Claims is right. The provisions of the 1918 Act here in question, relating to the deduction of ordinary and necessary expenses in carrying on business and forbidding the deduction of personal expenses, are found in the more recent Revenue Acts, and the questions what is a personal expense and what is a capital expenditure are constantly arising. There does not seem to be any third class of expenditures between ordinary business expenditures on the one hand and personal expenditures on the other. The expenditure in this case does not seem like a personal expense in any proper sense. It was an individual expense as distinguished from a firm expense, but that is a different matter. We infer that the shares of stock received by petitioner in 1918 were received as compensation for some services performed and that the question between him and his former partner was whether the services were performed during the existence of the law partnership or afterwards, or disconnected with it. If that be so, the value of the shares constituted taxable income and the expenditure of attorney's fees in defending the right to receive and retain that income would have been to enlarge the taxpayer's income subject to income taxes. An ex-

penditure for the purpose of obtaining or retaining taxable income does not seem like a personal expenditure.

We agree with the Court of Claims that the expenditure did not constitute a loss.

If the expense was a business rather than a personal expense, it can hardly be treated as a capital expenditure. While the petition in the Court of Claims is not clear, it may be that the shares of stock received were as compensation for legal or other services. Money expended to obtain or retain taxable income should be treated as a deduction from income and not as a capital expenditure.

We present below further extracts from the regulations of the Treasury and illustrations as to the rulings heretofore made in the Bureau of Internal Revenue on this subject.

*Personal and Family Expenses*, Art. 291, Reg. 45:

> Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives there clients, patients, or callers in connection with his professional work (his place of business being elsewhere), no part of the rent is deductible as a business expense. If, however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is

deductible. The father is legally entitled to the services of his minor children, and allowances which he gives them, whether said to be in consideration of services or otherwise, are not allowable deductions in his return of income. Alimony and an allowance paid under a separation agreement are not deductible from gross income. See article 73. The cost of the equipment of an army officer to the extent only that it is specially required by his profession and does not merely take the place of articles required in civilian life is deductible. Accordingly, the cost of a sword is an allowable deduction, but the cost of a uniform is not.

*Capital Expenditures*, Art. 293, Req. 45:

Amounts paid for increasing the capital value or for restoring the depreciated value of property are not deductible from gross income. See section 214 (a) (8) of the statute and article 161. Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architect's services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price. Expenses of the administration of an estate, such as court costs, attor-

ney's fees, and executor's commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or stockholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. See article 543. An assessment paid by a stockholder of a national bank on account of his statutory liability is similarly not deductible.

*Personal Expenses*

The Commissioner of Internal Revenue has ruled the following to be personal expenses:

(1) Amounts paid as damages for breach of promise to marry. C. B. 2, p. 157;

(2) Attorney's fees and other costs sustained by taxpayer in an action for breach of promise to marry. C. B. II–2, p. 61;

(3) Amounts expended in defending a suit for damages alleged to have been caused by the negligent operation of an automobile owned and operated for personal convenience. C. B. 4, p. 159;

(4) Attorney's fees paid by a taxpayer engaged in the retail drug business in connection with a prosecution for illegal sale of narcotics. C. B. 4, p. 209;

(5) Trial expenses and attorney's fees in defending a member of a partnership against criminal charges for violation of the Alien Property Act. C. B. IV–1, p. 170.

**The Board of Tax Appeals has held the following to be personal expenses:**

> **(1) Expense of defending an indictment for perjury growing out of taxpayer's business.** ***Appeal of Sara Backer et al.,*** **1 B. T. A. 214. In this case the Board laid down the following test: "We are dealing here with the age-old question of proximate cause. If the charge of perjury proximately resulted from the business * * * it may be conceded that the expense of defense against that charge was an ordinary and necessary expense of carrying on his business. If, on the other hand, the business of contracting was not proximately related to the charge of perjury, then the cost of defense was not a business expense * * *.**
>
> (2) Expense of defense in proceedings for violation of criminal provisions of the Trading with the Enemy Act. *Appeal of Norvin R. Lindheim,* 2 B. T. A. 229.

*Business Expenses*

The Commissioner of Internal Revenue has held attorney's fees and legal costs in the following cases to be business expenses:

> (1) Expense of defending title to a patent. C. B. 2, p. 105;
>
> (2) Attorney's fees incurred in defending suit for damages by a tenant working on the taxpayer's farm. C. B. 5, p. 121;
>
> (3) Legal expenses incurred by a taxpayer (a doctor) in defending a suit for malpractice in his profession. C. B. V–1, p. 227;

(4) **Attorney's fees and expenses incident to disbarment proceedings instituted against taxpayer, an attorney. C. B. V–1, p. 227; reversing C. B. IV–1, p. 140.**

The Board of Tax Appeals has held legal costs to be business expenses in the following case:

> The cost of an accounting required by court order to be made at the expense of the taxpayer to ascertain the damages resulting from taxpayer's infringement of a patent. *Appeal of Meyer & Bro. Co.*, 4 B. T. A. 481.

*Capital Expenditures*

The Commissioner of Internal Revenue has held the following legal expenses to be capital expenditures:

> (1) Attorneys' fees paid by a nonresident alien in securing the return of property and income from the Alien Property Custodian. C. B. 5, p. 127. In this case it is said: "* * * the mere ownership of property does not constitute 'carrying on' a business within the meaning of the statute, and such legal expenses, therefore, cannot be considered as ordinary and necessary expenses. The attorneys' fees in question should be considered a part of a capital transaction and treated in the same manner as commissions paid in purchasing or selling securities. If the Alien Property Custodian returned property, as distinguished from money, the attorneys' fees should be treated as a part of the cost price of the property. If the Alien

Property Custodian took over property, converted it into cash, and delivered money to the taxpayer, the attorneys' fees constitute an offset against the selling price."

(2) The cost of perfecting or defending title to or reducing an assessment for a local benefit against property. C. B. 3, p. 192. (Defense of enjoyment as well as title to property is included as illustrated by fees paid attorneys to contest the establishment of a building line against property. C. B. I-2, p. 146.)

(3) Cost of contesting a will whereby title and possession of property was obtained. C. B. II-1, p. 122.

The Board of Tax Appeals has held that attorney's fees or other legal expenses are capital expenditures in the following cases:

(1) *Appeal of Charles P. Howes*, 2 B. T. A. 1279. In this case the taxpayer, an individual, held a deed to land acquired by him from the original purchaser at a tax sale. Abutting property owners claimed this land to be a public alley by reason of adverse user. In establishing his title to the land the taxpayer expended $5,250 attorney's fees. The land was subsequently sold. In determining the value of taxpayer's interest in the land as of March 1, 1913, the Board held that the amount expended as attorney's fees was an additional capital expenditure which should be taken into consideration in computing the gain realized from the sale.

(2) *Appeal of Consolidated Mutual Oil Company*, 2 B. T. A. 1067. In this case the taxpayer, a corporation, in its individual tax return for 1918 deducted as an expense $958.30 paid out as reporter's fees in a suit unsuccessfully brought against it by the United States to oust it from the possession of certain oil lands. This amount was held by the Board to be a capital expenditure, rather than a business expense.

(3) *Appeal of Earl M. Palmer*, 3 B. T. A. 403. In this case taxpayer, an individual, took over the milling business of a friend named Stern, who was called into military service, under the terms of a contract which obligated the taxpayer to faithfully manage and continue the business. All the profits during Stern's military service were to be the taxpayer's, but upon Stern's return the taxpayer was to restore one-half of the business to him. When Stern returned, however, the taxpayer refused to carry out the agreement. Litigation for recission of contract and an accounting was instituted by Stern. The case was finally settled out of court, however, by the payment of $25,000 to Stern by the taxpayer, who thereafter continued to conduct the business. The taxpayer claimed deduction of the $25,000 as an expense. In disposing of the case the Board said:

"The question then arises as to whether the amount of $25,000, paid by the taxpayer in 1919 to Stern, constitutes an ordinary and

necessary business expense or a capital expenditure. It was paid to Stern in settlement of litigation over the question as to whether the conveyance and contract made between the parties were effective. The effect of the payment was that the taxpayer acquired the undisputed ownership of the business and became entitled to all profits arising therefrom. The court, if it had followed the recommendation of the master, would have held that the taxpayer had no interest in the business, except the salary which he drew and certain traveling expenses. It would have put the parties back in the same situation they were in while Stern owned and operated the business himself, and the taxpayer would have been required to account for the profits. By making the payment of $25,000 he saved to himself the business and its profits.

"In view of the foregoing facts, we are of the opinion that the said payment amounted to a capital expenditure and was not an ordinary and necessary expense."

The only court decision bearing on the question here under consideration is *Laemmle* v. *Eisner*, 275 Fed. 504. In this case the United States District Court for the Southern District of New York held that attorney's fees paid in litigation for control of certain stock, resulting in practically the ownership or control thereof and the consequent management of the company, constituted a capital investment rather than a business expense. The

opinion of the court is short and does not enter into a discussion of the principles.

Respectfully submitted.

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